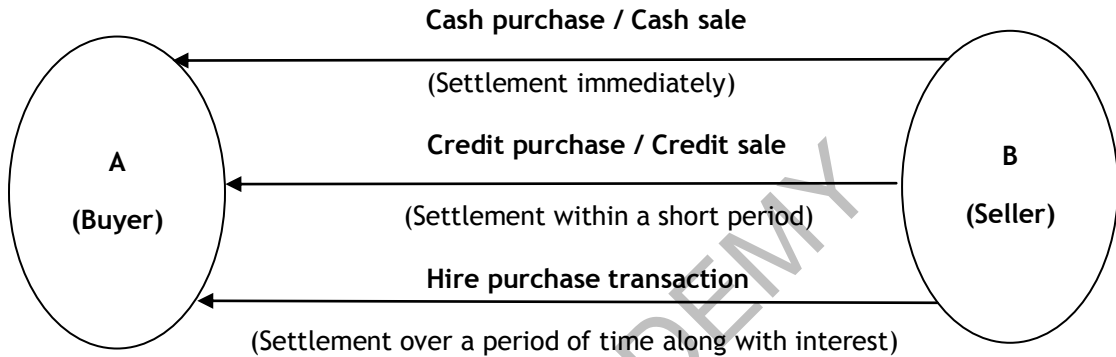


HIRE – PURCHASE AND INSTALMENT SALE TRANSACTIONS

INTRODUCTION



Accounting for purchase and sale:

In the books of buyer

Cash purchase

Asset A/c Dr.
 To Bank A/c

Credit purchase

Asset A/c Dr.
 To Creditors A/c

In the books of seller

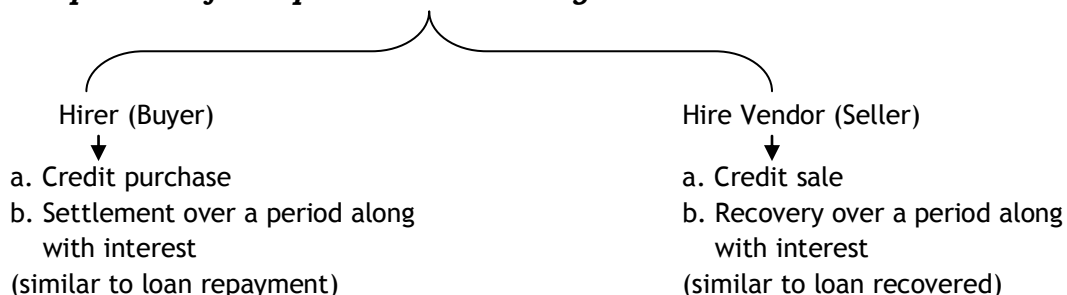
Cash sale

Bank A/c Dr.
 To Sales A/c

Debtors A/c Dr.
 To Sales A/c

MEANING

Hire purchase (HP) is a type of credit sale, where the seller hands over the possession of the goods to the buyer, usually for a part of the amount (down payment) and collects the remaining amount by way of instalments over a period of time; such instalments include the interest charges for the outstanding amount. In case of default by the buyer, the seller takes the goods back (repossession) and the amount so far paid by the buyer is treated as hire charges for the usage of the goods.

Components of hire purchase accounting:

*Interest represents compensation towards time value of money and risk of default.

FEATURES OF HIRE PURCHASE AGREEMENT

1. A hire purchase agreement involves two parties - Hire vendor and Hirer
2. Hire vendor conveys “only” the right to use the asset. i.e. the possession of the goods is transferred immediately after the hire purchase contract is made.
3. The legal ownership is transferred only on the payment of last instalment by the hirer. Till then, hire vendor is the registered owner. However, the hirer becomes the beneficial owner exclusively (enjoys all the benefits from the asset) during the hire purchase period with all the risks and rewards attached to the asset.
4. During hire purchase period, the hirer has the option to purchase the asset at any time by paying the balance instalments. The Hire vendor does not have right to refuse the transfer of ownership of the asset.
5. In the event of default in payment of instalments by hirer, the Hire vendor has the right to repossess the asset and adjust the amount due.

IMPORTANT TERMS USED

Term	Meaning
Hirer	Purchaser / user / borrower
Hire vendor	Seller / financier
Cash price (fair value)	Price at which a transaction will be settled immediately for cash
Down payment / signing amount	Amount paid by the hirer to Hire vendor on signing the agreement (Margin money). It represents consideration towards principal in entirety.

Instalments	Periodical payments made by the hirer to hire vendor during the Hire purchase period comprising principal and interest.
Hire purchase price	<ul style="list-style-type: none"> Down payment + aggregate instalments <p style="text-align: center;">or</p> <ul style="list-style-type: none"> Cash price + interest
Hire purchase interest	Hire purchase price - Cash price
Repossession value	Value at which the repossessed asset is adjusted by Hire vendor against the amount due from hirer in the event of default. It is computed in accordance with the terms of the Hire purchase agreement.

Illustration:

Mr. X is in need of a bike. A Hero Honda dealer offers him the said bike at ₹ 48,000 for ready cash else on HP, under the terms and conditions that the initial payment shall be ₹ 10,000 and the remaining ₹ 48,000 shall be payable by 8 equal instalments over a period of 24 months.

In the above illustration:

Hirer	Mr. X
Hire vendor	Hero Honda dealer
Cash price (fair value)	₹ 48,000
Down payment / signing amount	₹ 10,000
Instalments	₹ 6,000 (48,000/8)
HP price	₹ 58,000 (10,000+48,000)
HP interest	₹ 10,000 (58,000-48,000)

ACCOUNTING FOR HIRE PURCHASE TRANSACTION**Part I - Accounting in the books of Hirer – as per Accounting Standard 19**

The accounting involves capitalisation of asset and subsequent payment of consideration in instalments along with interest. These assets should be classified as 'Assets on hire purchase' in the Balance Sheet. Capitalisation of the asset is based on the fundamental accounting principle "Substance over form". Amount due to the Hire Vendor should be classified as "Hire Purchase Creditors" and shown on the Liabilities side of the Balance Sheet.

Journal entries:

Sl No	Particulars	Debit (₹)	Credit (₹)
1.	On signing the hire purchase agreement		
a.	Capitalisation of asset - at cash price Asset A/c To Hire Vendor A/c	Dr. 	xxx xxx
b.	Down payment Hire vendor A/c To Cash/Bank A/c	Dr. 	xxx xxx
2.	On the due date of the instalment		
a.	Interest accrued and due Interest A/c To Hire vendor A/c	Dr. 	xxx xxx
b.	Payment of instalment Hire Vendor A/c To Bank A/c	Dr. 	xxx xxx
3.	End of each accounting year		
a.	Interest accrued but not due Interest A/c To interest accrued but not due A/c (The amount of interest accrued but not due will be transferred to Party account when the instalment falls due)	Dr. 	xxx xxx
b.	Depreciation Depreciation A/c To Asset A/c/Depreciation reserve/ Provision for depreciation	Dr. 	xxx xxx
c.	Transfer to Profit & Loss - Interest & Depreciation Profit & Loss A/c To Interest A/c To Depreciation A/c	 Dr. 	 xxx xxx

Repossession of the asset

In case of default in the payment of instalments, Hire vendor can repossess the asset from the hirer and the instalments paid till default will be treated as 'Hire charges'. This act of asset recovery by the hire vendor is referred to as repossession. The balance outstanding in the hirer account (current and future instalments) will be the value of the repossessed asset. Such balance is transferred to a separate account called "Goods Repossessed Stock account". (in the books of Hire vendor A/c)

Asset repossessed is sold after proper repairing and reconditioning. Such expenses incurred are debited to the "Goods Repossessed stock A/c" and the sale proceeds of the asset are credited. The net gain or loss on such sale is transferred to the General Profit & Loss A/c.

Partial repossession

In case of partial repossession of the asset, some of the assets forming part of the Hire purchase contract are repossessed at a mutually agreed value. Such agreed upon value will be the repossessed value of the asset. The asset (not repossessed) lying with the hirer will be carried at the normal written down value.

Sl No	Particulars	Debit (₹)	Credit (₹)
1.	On repossession of the asset by hire vendor		
	a. When book value of the asset is greater than repossessed value		
	Hire vendor A/c (Repossession value) Dr.	xxx	
	Profit & Loss A/c (Loss- balancing figure) Dr.	xxx	
	To Asset A/c (Written down value)		xxx
	(or)		
	When book value of the asset is lesser than repossessed value		
	Hire vendor A/c (Repossession value) Dr.	xxx	
	To Asset A/c (Written down value)		xxx
	To Profit & Loss A/c (Gain - balancing figure)		xxx

<i>b. Settlement of balance in hire vendor account:</i>			
<i>i. When repossessed value is greater than amount due, hire vendor will settle the difference in cash.</i>			
<i>Bank A/c</i>	<i>Dr.</i>	<i>xxx</i>	
<i>To Hire vendor A/c</i>			<i>xxx</i>
(or)			
<i>ii. When repossessed value is less than the amount due and the amount is waived by the hire vendor/settled by the hirer</i>			
<i>Hire vendor A/c</i>	<i>Dr.</i>	<i>xxx</i>	
<i>To Profit & Loss A/c / Bank A/c</i>			<i>xxx</i>

Part II - Accounting in the books of Hire vendor

In the case of Hirer, hire purchase is generally a last option for asset financing, since it is costlier and has risk of repossession of asset in the event of default in payment of the instalments. Thus, assets taken on hire by Hirer are usually few in number and one method of accounting (as discussed earlier) becomes possible.

Whereas in the case of Hire vendor, the profile of Hire vendors could be either of the following

- a. Hire vendor whose principal business is not hire purchase
Eg. Automobile manufacturers like Tata Motors who predominantly sells on cash/credit basis to dealers, sells few trucks on Hire Purchase (HP) basis.
- b. Hire vendor who carry on hire purchase business on large scale.
Eg. Finance companies such as Sundaram Finance, Bajaj Auto Finance
- c. Hire vendor who carry on hire purchase business in a proprietary manner, but on a reasonable scale.
Eg. Proprietary finance firms

Since the profile of Hire vendors are different, the method of accounting is also different based on the volume, required level of control etc., The following are the three methods for the above three categories of Hire vendors: (sequentially)